

in paragraphs (b) and (c) of this section.

(2) The Director of the Division of Economic Analysis may submit any matter which has been delegated to the Director under paragraph (f)(1) of this section to the Commission for its consideration.

(Secs. 8a(5) and 19 of the Commodity Exchange Act, as amended 7 U.S.C. 12a(5) and 23 (1982))

[49 FR 5529, Feb. 13, 1984, as amended at 50 FR 27, Jan. 2, 1985; 50 FR 2283, Jan. 16, 1985; 54 FR 41079, Oct. 5, 1989]

§31.7 Maintenance of minimum financial, cover and segregation requirements by leverage transaction merchants.

(a) Each person registered as a leverage transaction merchant or who files an application for registration as a leverage transaction merchant, who knows or should have known that its adjusted net capital at any time is less than the minimum required by §31.9, or that its cover at any time is less than the minimum required by §31.8, or that the amount of leverage customer funds in segregation is less than is required by §31.12 or by the capital, cover or segregation rules of any designated self-regulatory organization to which such person is subject, if any, must:

(1) Give telegraphic notice as set forth in §1.12(g) of this chapter that such applicant's or registrant's adjusted net capital is less than is required by §31.9, or its cover is less than is required by §31.8, or the amount of leverage customer funds in segregation is less than is required by §31.12 or by such other capital, cover or segregation rule, identifying the applicable capital, cover or segregation rule. This notice must be given within 24 hours after such applicant or registrant knows or should have known that its adjusted net capital or its cover or the amount of leverage customer funds in segregation is less than is required by any of the aforesaid rules to which such applicant or registrant is subject; and

(2) Within 24 hours after giving such notice file a statement of financial condition, a statement of the computation of the minimum capital requirements pursuant to §31.9 (computed in

accordance with the applicable capital rule), a schedule of coverage requirements and coverage provided, and a schedule of segregation requirements and funds on deposit in segregation, all as of the date such applicant's or registrant's adjusted net capital or its cover or the amount of leverage customer funds in segregation became less than the minimum required.

(b) Each person registered as a leverage transaction merchant, or who files an application for registration as a leverage transaction merchant, who knows or should have known that its adjusted net capital at any time is less than 120 percent of the amount required by §31.9 must file written notice to that effect as set forth in §1.12(g) of this chapter within five business days of such event. Such applicant or registrant must also file a Form 2-FR or such other financial statement designated by the Commission and/or the designated self-regulatory organization, if any, as of the close of business for the month during which such event takes place and as of the close of business for each month thereafter until three successive months have elapsed during which the applicant's or registrant's adjusted net capital is at all times equal to or in excess of the minimums set forth in this paragraph (b). Each financial report required by this paragraph (b) must be filed within 30 calendar days after the end of the month for which such report is being made.

(c) The requirements of §§1.12(c), 1.12(d), 1.12(e) and 1.12(g) of this chapter shall apply to registered leverage transaction merchants and to persons who have applied for registration as leverage transaction merchants, as if in those paragraphs the term "leverage transaction merchant or applicant therefor" were substituted for the phrase "applicant or registrant."

(Secs. 8a(5) and 19 of the Commodity Exchange Act, as amended, 7 U.S.C. 12a(5) and 23 (1982))

[49 FR 5530, Feb. 13, 1984, as amended at 50 FR 28, Jan. 2, 1985; 54 FR 41079, Oct. 5, 1989]

§31.8 Cover of leverage contracts.

(a)(1) Each leverage transaction merchant must at all times maintain cover of at least 90 percent of the amount of

physical commodities subject to open long leverage contracts entered into with leverage customers, and must at all times also maintain cover of at least 90 percent of the amount of physical commodities subject to open short leverage contracts entered into with leverage customers. At least 25 percent of the amount of physical commodities subject to open long leverage contracts must be covered by the types of permissible cover set forth in paragraphs (a)(2)(i) and (ii) of this section.

(2) Permissible cover for a long leverage contract is limited to:

(i) Warehouse receipts for the leverage commodity subject to the leverage contract held in commercial banks located in the United States or in approved contract market depositories: *Provided*, That the balance of the principal and accrued interest on any loan against such warehouse receipts does not exceed 70 percent of the current market value of the commodity represented by each receipt.

(ii) Warehouse receipts for gold bullion in the case of leverage contracts on bulk gold coins, bulk gold coins in the case of leverage contracts on gold bullion, silver bullion in the case of leverage contracts on bulk silver coins, bulk silver coins in the case of leverage contracts on silver bullion, one type of bulk gold coins for leverage contracts involving another type of bulk gold coins on an ounce-for-ounce basis if each type of bulk gold coins used as cover is the subject of a leverage contract offered by the leverage transaction merchant pursuant to registration under §31.6 of this part, and one type of bulk silver coins for leverage contracts involving another type of bulk silver coins on an ounce-for-ounce basis if each type of bulk silver coins used as cover is the subject of a leverage contract offered by the leverage transaction merchant pursuant to registration under §31.6 of this part, which are held in commercial banks located in the United States or in approved contract market depositories: *Provided*, That the balance of the principal and accrued interest on any loans against such warehouse receipts does not exceed 70 percent of the current market value of the commodity for which it represents cover.

(iii) Purchase, in physical form, of the leverage commodity subject to the leverage contract, or of the same alternative commodities provided for in paragraph (a)(2)(ii) of this section, with settlement within two business days shall be considered permissible cover from the time the purchase order is confirmed, even though the leverage transaction merchant does not have possession or control of a warehouse receipt until settlement: *Provided, however*, That such purchases are not made from an affiliated firm, and such purchases at no time constitute more than 10 percent of the amount of physical commodities subject to open long leverage contracts entered into with leverage customers: *And, provided further*, That the leverage transaction merchant maintains, in accordance with §31.14 of this part, detailed records of these transactions which will be subject to inspection, copying and audit by the Commission and a designated self-regulatory organization.

(iv) A long spot futures contract on the leverage commodity subject to the leverage contract, or of the same alternative commodities provided for in paragraph (a)(2)(ii) of this section, if the leverage transaction merchant has stopped a delivery notice which is non-transferable with respect to that futures contract and has otherwise complied with any procedures, including payment, necessary for taking delivery, even though the leverage transaction merchant does not have possession or control of a warehouse receipt for two business days: *Provided, however*, That the amount of physical commodities subject to such long spot futures contracts at no time constitutes more than 10 percent of the amount of physical commodities subject to open long leverage contracts entered into with leverage customers: *And, provided further*, That the leverage transaction merchant maintains, in accordance with §31.14 of this part, detailed records of its deliveries on futures contracts, which will be subject to inspection, copying and audit by the Commission and a designated self-regulatory organization.

(v)(A) Purchases for future delivery on or subject to the rules of the contract market of the same generic commodity subject to the leverage contract, or of the same alternative commodities provided for in paragraph (a)(2)(ii) of this section; or

(B) Purchases of call commodity options for the same generic commodity subject to the leverage contract, or of the same alternative commodities provided for in paragraph (a)(2)(ii) of this section, on or subject to the rules of a contract market in accordance with the provisions of part 33 of this chapter: *Provided*, That the market value of the actual commodity or futures contract which is the subject of such option is more than the value of the underlying commodity based on the strike price of the option.

(3) Permissible cover for a short leverage contract is limited to:

(i) Sales for future delivery on or subject to the rules of a contract market of the same generic commodity subject to the leverage contract, or of the same alternative commodities provided for in paragraph (a)(2)(ii) of this section; or

(ii) Purchases of put commodity options for the same generic commodity subject to the leverage contract, or of the same alternative commodities provided for in paragraph (a)(2)(ii) of this section, on or subject to the rules of a contract market in accordance with the provisions of part 33 of this chapter: *Provided*, That the market value of the actual commodity or futures contract which is the subject of such option is less than the value of the underlying commodity based on the strike price of the option.

(b) Such leverage transaction merchant must be in compliance with paragraph (a) of this section at all times and must be able to demonstrate such compliance to the satisfaction of the Commission and/or the designated self-regulatory organization. A leverage transaction merchant who is not in compliance with paragraph (a) of this section or in unable to demonstrate such compliance must immediately cease engaging in the business of offering to enter into, entering into, or confirming the execution of, any leverage contract until such time as the lever-

age transaction merchant is able to demonstrate such compliance. Nothing in this paragraph (b) shall be construed as preventing the Commission or the designated self-regulatory organization from taking action against a leverage transaction merchant for non-compliance with any of the provisions of this section.

(c) The amount of cover which is actually maintained by a leverage transaction merchant, and the amount of cover which must be maintained by a leverage transaction merchant in order to comply with the requirements of this section, shall be computed as of the close of each business day by the leverage transaction merchant. A written record of this computation shall be made and kept, together with all supporting data, in accordance with the provisions of § 1.31 of this chapter. This daily computation shall be made by noon on the next business day and shall be computed in a format identical to the Schedule of Coverage Requirements and Coverage Provided contained in Form 2-FR. In computing the amount of cover actually maintained, the leverage transaction merchant shall include only those warehouse receipts which are unencumbered or against which the balance of the principal and accrued interest on cash loans for which such receipts serve as collateral does not exceed 70 percent of the current market value of the commodities underlying such receipts.

(d) A leverage transaction merchant who uses as collateral for cash loans warehouse receipts held as cover for leverage contracts shall maintain a separate record for such loans which contains the following information:

(1) The date on which the loan was made;

(2) The name of the commercial bank or futures commission merchant making such loan;

(3) The purpose for which the loan was made;

(4) The amount of the loan;

(5) The interest rate on the loan;

(6) The loan's maturity date;

(7) The date of any partial or complete liquidation of the loan; and

(8) A description of the warehouse receipt collateralizing such loan including the receipt number, the issuer's

name, and the total quantity of the commodity covered by the warehouse receipt. Such loans shall be evidenced in a written agreement executed by the leverage transaction merchant and the lender. The leverage transaction merchant shall retain such agreement and any related notes in accordance with the requirements of §31.14 of this part.

(e) The requirements of paragraphs (a) through (d) of this section shall not be applicable if the leverage transaction merchant is a member of a designated self-regulatory organization and conforms to minimum cover standards and related reporting requirements set by such designated self-regulatory organization in its bylaws, rules, regulations or resolutions approved by the Commission pursuant to section 19 of the Act and §31.28 of this part.

(Secs. 8a(5) and 19 of the Commodity Exchange Act, as amended, 7 U.S.C. 12a(5) and 23 (1982))

[49 FR 5531, Feb. 13, 1984, as amended at 50 FR 28, Jan. 2, 1985; 54 FR 41079, Oct. 5, 1989]

§31.9 Minimum financial requirements.

(a) Each leverage transaction merchant must at all times maintain adjusted net capital equal to or in excess of \$2,500,000, plus 20 percent of the market value of the amount of physical commodities subject to leverage contracts entered into by the leverage transaction merchant which are uncovered, plus 2½ percent of the market value of the amount of physical commodities subject to short leverage contracts entered into by the leverage transaction merchant which are covered.

(1) For purposes of determining compliance with the provisions of paragraph (a) of this section, each leverage transaction merchant must compute the market value of the physical commodities subject to leverage contracts which it has entered into by using the widely accepted and broadly disseminated commercial or retail cash price series submitted with the leverage transaction merchant's application for registration of the leverage commodity in accordance with §31.6, and cannot include any mark-ups or discounts of the leverage transaction merchant.

(2) The requirements of paragraph (a) of this section shall not be applicable if the applicant or registrant is a member of a designated self-regulatory organization and conforms to minimum financial standards and related reporting requirements set by such designated self-regulatory organization in its bylaws, rules, regulations or resolutions approved by the Commission pursuant to section 19 of the Act and §31.28 of this part.

(3) No person applying for registration as a leverage transaction merchant shall be so registered unless such person affirmatively demonstrates to the satisfaction of the Commission that it complies with the financial requirements of this section. Each leverage transaction merchant must be in compliance with this section at all times and must be able to demonstrate such compliance to the satisfaction of the Commission and/or the designated self-regulatory organization.

(4) A leverage transaction merchant who is not in compliance with this section, or is unable to demonstrate such compliance as required by paragraph (a)(3) of this section, must immediately cease engaging in the business of offering to enter into, entering into, or confirming the execution of, any leverage contract until such time as the leverage transaction merchant is able to demonstrate such compliance. Nothing in this paragraph shall be construed as preventing the Commission or the designated self-regulatory organization from taking action against a leverage transaction merchant for non-compliance with any of the provisions of this section. Any leverage transaction merchant required immediately to cease doing business under this paragraph shall remain liable on all leverage contracts previously entered into until all rights of and obligations owing to the customers thereunder have been fulfilled.

(b) For the purposes of this section:

(1) Where the applicant or registrant has an asset or liability which is defined in Securities Exchange Act rule 15c3-1 (§240.15c3-1 of this title), the inclusion or exclusion of all or part of such asset or liability for the computation of adjusted net capital shall be in accordance with §240.15c3-1 of this